

TESTIMONY OF
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PRESIDENT, REGULATION UnFETTERED
BEFORE THE
MICHIGAN SENATE ENERGY AND TECHNOLOGY COMMITTEE
NOVEMBER 1, 2011

GOOD AFTERNOON, MR. CHAIRMAN AND MEMBERS OF THE
COMMITTEE,

THANK YOU FOR THIS OPPORTUNITY TO TESTIFY ABOUT HOW
THE REGULATORY REFORMS ENACTED BY THE MICHIGAN
LEGISLATURE IN 2008 HAVE AFFECTED THE PERCEPTIONS OF THE
FINANCIAL COMMUNITY VIS-À-VIS MICHIGAN'S ELECTRIC UTILITIES.

FOR ME, TODAY IS SOMETHING OF A HOMECOMING – 28
YEARS AGO I CREATED THE OFFICE OF SENATE MAJORITY
COUNSEL UNDER SENATE MAJORITY LEADER JOHN ENGLER, AND I
SERVED IN THAT ROLE FOR TWO YEARS. LATER ON, I WAS
APPOINTED TO A REPUBLICAN SEAT ON THE MICHIGAN PUBLIC
SERVICE COMMISSION BY GOVERNOR JIM BLANCHARD, AND THEN
WAS ELEVATED TO CHAIRMAN BY GOVERNOR JOHN ENGLER, WHO
ALSO REAPPOINTED ME. THEREAFTER I WORKED FOR 8 ½ YEARS

AT FITCH RATINGS, ONE OF THE THREE MAJOR RATING AGENCIES, THE LAST FOUR YEARS OF THAT TIME AS MANAGING DIRECTOR OF THE FITCH UTILITY RATINGS PRACTICE IN NEW YORK AND CHICAGO. I NOW SERVE AS AN INDEPENDENT UTILITY CONSULTANT, AND WHILE I PRIMARILY WORK WITH REGULATED UTILITIES, I'M SOMEWHAT UNUSUAL IN THAT I HAVE ALSO WORKED WITH PUBLIC UTILITY COMMISSIONS AND CONSUMER ADVOCATES.

I KNOW I DON'T NEED TO GO INTO GREAT DETAIL WITH THIS COMMITTEE ABOUT HOW THE MICHIGAN LEGISLATURE EFFECTED SIGNIFICANT INSTITUTIONAL CHANGE TO THE UTILITY REGULATORY FRAMEWORK WITHIN THE STATE. LET ME JUST NOTE THE KEY COMPONENTS OF THE LAW THAT DREW THE MOST ATTENTION FROM THE FINANCIAL COMMUNITY:

- 1) PROVIDING CUSTOMERS WITH CHOICE OF ELECTRICITY SUPPLIERS, BUT CAPPING THAT CHOICE AT 10% TO HELP PROTECT THE FINANCIAL INTEGRITY OF THE STATE'S ELECTRIC UTILITIES;
- 2) ALLOWING FILE AND USE RATEMAKING WITH A FIRM TWELVE- MONTH DEADLINE FOR THE MICHIGAN PSC TO CONCLUDE A RATE CASE; AFTER SIX MONTHS, A UTILITY'S

PROPOSED RATES COULD BE SELF-IMPLEMENTED, BUT CUSTOMERS WOULD BE PROTECTED THROUGH A REQUIRED TRUE-UP WITH POTENTIAL REFUNDS WITH INTEREST;

- 3) PERMITTING A UTILITY TO USE A FUTURE TEST YEAR IN DEVELOPING ITS RATE CASE, TO LIMIT REGULATORY LAG RELATED TO IN PROCESS OR PLANNED RATE BASE ADDITIONS;
 - 4) INSTITUTING A CERTIFICATE OF NEED PROCESS FOR MAJOR CAPITAL PROJECTS COSTING MORE THAN \$500 MILLION, WITH THE ABILITY TO RECOVER INTEREST COSTS DURING CONSTRUCTION THROUGH A POLICY CALLED "CONSTRUCTION WORK IN PROGRESS", ALSO KNOWN AS CWIP;
 - 5) CALLING FOR DESKEWING OF RATES OVER FIVE YEARS SO THAT ALL CUSTOMER CLASSES WOULD PAY RATES BASED UPON THEIR CLASS' COST-OF-SERVICE, THEREBY IMPROVING THE BUSINESS CLIMATE WITHIN THE STATE;
- AND

6) SETTING A 10% RENEWABLE ENERGY REQUIREMENT WITH A MAXIMUM RATE SURCHARGE, ALONG WITH INCENTIVES AND TAX CREDITS FOR CUSTOMERS INVESTING IN ENERGY EFFICIENCY.

THE THREE MAJOR RATING AGENCIES HAVE VERY POSITIVE THINGS TO SAY ABOUT THE 2008 ENERGY LEGISLATION:

STANDARD & POORS HAS STATED THAT REGULATORY RISK IN MICHIGAN HAS DECREASED AS A RESULT OF THE PERMANENT REFORMS TO THE REGULATORY PROCESS ENACTED BY THE MICHIGAN LEGISLATURE, WITH SPECIFIC REFERENCE TO THE TWELVE-MONTH DEADLINE FOR RATE CASES, THE SIX-MONTH SELF-IMPLEMENTATION OF RATE INCREASES, A FORWARD-LOOKING TEST YEAR, AND THE 10% CAP ON ELECTRIC CHOICE.

MOODY'S CITES THOSE SAME ASPECTS OF THE LAW IN STATING THAT THE REGULATORY ENVIRONMENT IN MICHIGAN IS ABOVE AVERAGE IN TERMS OF SUPPORTIVENESS OF UTILITY CREDIT QUALITY. MOODY'S GOES ON TO CITE OTHER LEGISLATIVE AND MICHIGAN PSC POLICIES CONSISTENT WITH A FAVORABLE REGULATORY CLIMATE, INCLUDING A SURCHARGE MECHANISM TO

PAY FOR RENEWABLE ENERGY INVESTMENTS, A REVENUE DECOUPLING MECHANISM TO HELP UTILITIES COVER THEIR FIXED COSTS IN THE FACE OF DECLINING CUSTOMER USAGE, AND IMPROVED CERTAINTY OF COST RECOVERY FOR LARGE PROJECTS THROUGH A CERTIFICATE OF NEED PROCESS.

FITCH, MY FORMER EMPLOYER AGREES WITH ITS TWO COMPETITORS AS TO THE POSITIVE NATURE OF THE LEGISLATION, ADDITIONALLY CITING A REDUCTION IN REGULATORY LAG AS A SIGNIFICANT IMPROVEMENT.

WHY, YOU MAY ASK, DOES IT MATTER WHAT THE RATING AGENCIES SAY?

AS RESPECTED ECONOMIST CHARLES F. PHILLIPS STATES IN HIS OFT-CITED TREATISE ON UTILITY REGULATION:

BOND RATINGS ARE IMPORTANT [BECAUSE] THEY DETERMINE, IN PART, THE COST OF NEW DEBT, SINCE BOTH THE INTEREST CHARGES ON NEW DEBT AND THE DEGREE OF DIFFICULTY IN MARKETING NEW ISSUES TEND TO RISE AS THE RATING DECREASES; AND [BOND RATINGS ALSO] HAVE AN INDIRECT BEARING ON THE STATUS OF A UTILITY'S STOCK AND ON ITS ACCEPTANCE IN THE MARKET.

THUS, A UTILITY WITH STRONG CREDIT RATINGS IS NOT ONLY ABLE TO ACCESS THE CAPITAL MARKETS ON A TIMELY BASIS AT REASONABLE RATES, BUT IT IS ALSO ABLE TO SHARE THE BENEFIT FROM THOSE ATTRACTIVE INTEREST RATE LEVELS WITH CUSTOMERS, SINCE COST OF CAPITAL GETS FACTORED INTO UTILITY RATES. CONVERSELY, THE LOWER A UTILITY'S CREDIT RATING, THE MORE THE UTILITY MUST PAY TO RAISE FUNDS FROM DEBT AND EQUITY INVESTORS TO CARRY OUT ITS CAPITAL-INTENSIVE OPERATIONS, AND THESE HIGHER CAPITAL COSTS GET FACTORED INTO THE RATES THAT CONSUMERS ARE REQUIRED TO PAY.

BEING ABLE TO ACCESS AFFORDABLE FUNDING WHEN NEEDED IS ESPECIALLY IMPORTANT HERE BECAUSE MICHIGAN HAS BEEN AMONG THE STATES HARDEST HIT BY THE RECENT RECESSION. WHILE THE STATE IS SLOWLY WORKING ITS WAY BACK, THE NEED FOR SUBSTANTIAL UTILITY CAPITAL SPENDING HAS NOT ABATED. WITHOUT A CONSISTENT AND CONSTRUCTIVE REGULATORY ENVIRONMENT, UTILITIES WILL FACE DIFFICULTIES ATTRACTING THE FUNDS NEEDED TO ENSURE RELIABILITY AND

SAFETY; MEET EVOLVING ENVIRONMENTAL MANDATES; AND, ULTIMATELY, RESPOND TO GROWING DEMAND.

OTHER REGULATORY OBSERVERS WITHIN THE FINANCIAL COMMUNITY ALSO SEE POSITIVE MOVEMENT IN MICHIGAN'S REGULATORY FRAMEWORK. REGULATORY RESEARCH ASSOCIATES, OR RRA, A RESPECTED COMMENTATOR ON REGULATORY ACTIONS AND POLICIES ALSO PUBLISHES A RANKING OF STATES WITH REGARD TO SUPPORTIVENESS OF THE REGULATED UTILITIES OPERATING WITHIN A PARTICULAR JURISDICTION. RRA RANKS MICHIGAN AMONG THE TOP 18 STATES, WITH SEVEN STATES RATED HIGHER AND TEN EQUAL TO MICHIGAN. RRA MARKS THE TIME OF ENACTMENT OF THE 2008 LEGISLATION AS A KEY POINT OF POSITIVE MOVEMENT, STATING THAT:

... MICHIGAN REGULATION HAS BEEN CONSTRUCTIVE OVER THE LAST COUPLE OF YEARS. LEGISLATION ENACTED IN 2008 STREAMLINED THE RATE CASE PROCESS AND CODIFIED A FRAMEWORK FOR THE UTILIZATION OF FORECASTED TEST YEARS AND THE IMPLEMENTATION OF INTERIM RATE INCREASES TO REDUCE REGULATORY LAG. THE LEGISLATION ALSO ESTABLISHED A PSC REVIEW PROCESS FOR SIGNIFICANT NEW INFRASTRUCTURE PROJECTS, PERMITS A CASH RETURN ON CONSTRUCTION WORK

IN PROGRESS, AND REDUCES THE UNCERTAINTY OF COST RECOVERY.

IN ADDITION, ON THE EQUITY SIDE, PRIOR TO THE 2008 LAW, BARCLAY'S INVESTMENT BANKING UNIT RANKED MICHIGAN UTILITY REGULATION RIGHT IN THE MIDDLE OF THE PACK WITH REGARD TO SHAREHOLDER ORIENTATION VERSUS CONSUMER ORIENTATION. WITH THE CERTAINTY PROVIDED BY THE NEW LAW, BARCLAY'S NOW RANKS MICHIGAN AMONG THE TOP 15 IN FINANCIAL COMMUNITY SUPPORTIVENESS. AS BARCLAY'S HAS STATED: "MICHIGAN REGULATION HAS SIGNIFICANTLY IMPROVED" SINCE THE 2008 LEGISLATION. WHAT THIS MEANS IS THAT IN TIMES OF ECONOMIC STRESS, MICHIGAN'S ELECTRIC UTILITIES WILL HAVE A BETTER CHANCE OF ACCESSING THE EQUITY AND DEBT MARKETS WHEN NEEDED AND UPON REASONABLE TERMS – A STEP THAT MANY REGULATED UTILITIES IN THE U.S. COULD NOT EASILY ACCOMPLISH DURING THE RECENT FINANCIAL CRISIS.

ON A PERSONAL NOTE, BACK WHEN I SERVED AS CHAIRMAN OF THE MICHIGAN COMMISSION, WHENEVER A RATE CASE EXTENDED BEYOND THE NINE-MONTH

STATUTORY GUIDELINE, ALL WE HAD TO DO WAS NOTIFY THE GOVERNOR, THE PRESIDENT OF THE SENATE, AND THE HOUSE SPEAKER THAT WE HAD MISSED THE TARGET AND DISCUSS THE STEPS WE'D BE TAKING TO EXPEDITE THE CASE. INTERNALLY, MY FELLOW COMMISSIONERS AND I INSTITUTED A CASE-HANDLING GUIDELINE THAT SOUGHT TO CONCLUDE ALL CASES WITHIN NINE MONTHS, UNLESS THERE WAS A PARTICULARLY COMPLEX CASE, IN WHICH CASE THE TARGET WOULD BE TWELVE MONTHS. THE MPSC HAD ABOUT A DOZEN ADMINISTRATIVE LAW JUDGES BACK THEN – AND MOST OF THEM HAD BEEN AT THE AGENCY FOR A VERY LONG TIME. I LIKED THEM ALL, BUT WHEN I MET WITH THEM TO DISCUSS THE NEW CASE-HANDLING GUIDELINE, AFTER I SPOKE, THEY TOLD ME THAT THEY WERE HERE BEFORE ME, THEY'D BE HERE AFTER ME, THAT OTHER CHAIRMEN HAD TALKED ABOUT THIS IDEA FOR MANY YEARS – AND THAT IT HAD NEVER HAPPENED BEFORE -- IN LARGE PART, THEY NOTED, BECAUSE THE COMMISSIONERS THEMSELVES WOULDN'T FOLLOW THEIR OWN RULES. AND SO, THEY

CONCLUDED, THEY DOUBTED THAT IT WOULD BE HAPPENING THIS TIME.

I TOLD THEM, THAT THAT WAS PRECISELY THE PROBLEM – JUST TALKING ABOUT IT WASN'T GOING TO RESOLVE THE ISSUE. I TOLD THEM, DON'T WATCH WHAT WE, THE COMMISSIONERS, SAY; WATCH WHAT WE DO. AND BEFORE A YEAR HAD PASSED, THE ENTIRE MICHIGAN PSC WORKING TOGETHER -- COMMISSIONERS, STAFFERS, YES, THOSE ALJ'S – AND ALSO ALL THE STAKEHOLDERS PARTICIPATING IN PSC CASES – WE ALL HAD ACHIEVED THE GOAL OF ELIMINATING THE AGENCY'S CASE BACKLOG FOR THE FIRST TIME IN 23 YEARS. THE DETROIT NEWS AND THE FREE PRESS AGREED WITH EACH OTHER THAT THE MPSC HAD DONE A REALLY GOOD THING: NOW HOW OFTEN DOES THAT HAPPEN? SO NEEDLESS TO SAY, I WAS THRILLED WHEN THE 2008 LAW WAS ENACTED, FINALLY CODIFYING A CASE-HANDLING MANDATE THAT WOULD ACTUALLY SERVE TO DIMINISH THE EVILS OF REGULATORY LAG.

THANK YOU. I'M HAPPY TO RESPOND TO ANY QUESTIONS OR LISTEN TO YOUR COMMENTS.

Steve Fetter
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STEVE FETTER is President of REGULATION UnFETTERED, an energy advisory firm based in Nordland, Washington (www.RegUnF.com).

The firm's focus has been regulatory, legislative, legal, and financial advisory services, including state and federal testimony, credit ratings advisory assistance, and dispute resolution through arbitration and mediation. During the ten years that the firm has been in existence, Steve has testified in over 85 regulatory, legislative and judicial proceedings on the subjects of credit risk within the utility sector, electric and natural gas utility restructuring, fuel and purchased power and other energy adjustment mechanisms, demand-side management revenue decoupling, utility securitization bonds, and nuclear energy. His clients include investor-owned and municipal electric, gas and water utilities, public utility commissions, consumer advocates, non-utility energy suppliers, international financial services and consulting firms, and investors.

After serving as Chairman of the Michigan Public Service Commission, Steve led the Fitch utility credit ratings team while establishing a national reputation for interpreting the financial impact of regulatory and legislative developments on the evolving energy sector. In February 2002, Steve was appointed to the CH Energy Group Board of Directors and he currently serves as Chairman of the Governance and Nominating Committee, having previously served as Independent Lead Director, Chairman of the Audit Committee, and Chairman of the Compensation and Succession Committee. Steve is a member of the Wall Street Utility Group and has previously served as Chairman of the Board of the National Regulatory Research Institute (NRRI), the research arm for the fifty state and D.C. public utility commissions.

Earlier, Steve served as Acting Associate Deputy Under Secretary at the U.S. Department of Labor, Majority General Counsel to the Michigan Senate, Assistant Legal Counsel to Governor William Milliken of Michigan, and as an appellate litigation attorney at the National Labor Relations Board.

Steve holds both undergraduate (Communications) and juris doctor degrees from the University of Michigan. Prior to attending law school, Steve was a horse-race announcer at The Meadows outside Pittsburgh, Pennsylvania.

1. The first part of the report discusses the general situation of the country and the progress of the work. It is noted that the work has been carried out in accordance with the plan and that the results are satisfactory. The second part of the report discusses the specific work done in the various departments. It is noted that the work has been carried out in accordance with the plan and that the results are satisfactory. The third part of the report discusses the financial situation of the country. It is noted that the financial situation is satisfactory and that the work has been carried out in accordance with the plan. The fourth part of the report discusses the social situation of the country. It is noted that the social situation is satisfactory and that the work has been carried out in accordance with the plan. The fifth part of the report discusses the cultural situation of the country. It is noted that the cultural situation is satisfactory and that the work has been carried out in accordance with the plan. The sixth part of the report discusses the educational situation of the country. It is noted that the educational situation is satisfactory and that the work has been carried out in accordance with the plan. The seventh part of the report discusses the health situation of the country. It is noted that the health situation is satisfactory and that the work has been carried out in accordance with the plan. The eighth part of the report discusses the labor situation of the country. It is noted that the labor situation is satisfactory and that the work has been carried out in accordance with the plan. The ninth part of the report discusses the military situation of the country. It is noted that the military situation is satisfactory and that the work has been carried out in accordance with the plan. The tenth part of the report discusses the foreign relations of the country. It is noted that the foreign relations are satisfactory and that the work has been carried out in accordance with the plan. The eleventh part of the report discusses the internal security of the country. It is noted that the internal security is satisfactory and that the work has been carried out in accordance with the plan. The twelfth part of the report discusses the overall situation of the country. It is noted that the overall situation is satisfactory and that the work has been carried out in accordance with the plan.